

Section 513.-Unrelated Trade or Business 26 CFR 1.513-1:
Definition of unrelated trade or business. (Also Section 501:
1.501(c)(3)-1.)

Unrelated income; hospital; laboratory services for private patients of staff physicians. The Service will not follow that portion of the decision in *St. Luke's Hospital of Kansas City v. U.S.* that held that a tax-exempt hospital's performance of laboratory testing upon referred specimens from private patients of the hospital's staff physicians is not unrelated trade or business because the services were performed for the convenience of the hospital's members. The Service disagrees with the court's characterization of staff physicians as members of the hospital.

ISSUE

To what extent will the Internal Revenue Service follow the decision in *St. Luke's Hospital of Kansas City v. United States*, 494 F. Supp. 85 (W.D. Mo. 1980), holding that a tax-exempt hospital's performance of diagnostic laboratory testing upon specimens of patients of the hospital's staff physicians is not unrelated trade or business under section 513(a) of the Internal Revenue Code?

FACTS

The hospital is exempt from federal income tax under section 501(c)(3) of the Code. Among its activities, it performs diagnostic laboratory testing upon issue specimens from private office patients of its staff physicians. Staff physicians are those who have the privilege of admitting patients to the hospital and treating them there. Each staff physician collects specimens from the physician's own private patients at the physician's office. This program is relatively small in size compared to the other activities of the pathology department, and business is not actively solicited through advertising or otherwise. The hospital sends an employee to pick up the specimens and to deliver them to the hospital. The hospital bills the patients of its staff physicians for its services. These patients do not themselves enter the hospital for diagnosis or treatment.

The hospital also is organized to operate a school for teaching residents, interns, medical students, and nurses. The school uses the tissue specimens from private patients of the hospital's staff physicians to assist in training its students. These specimens provide a supply in addition to those taken from the hospital's own patients.

The district court held that the hospital was not engaged in unrelated trade or business within the meaning of section 513 of the Code. The court found that the hospital needed the specimens to carry on its educational activities. As an independent basis

for its holding, the court also stated that the hospital's staff physicians were 'members' of the hospital within the meaning of section 513(a)(2) and that testing was performed by the hospital primarily for the convenience of the hospital's members.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term 'charitable' is used in section 501(c)(3) of the Code in its generally accepted legal sense.

In the general law of charity, the promotion of health is considered to be a charitable purpose. Restatement (Second) of Trusts, sections 368, 372; Bogart, Trusts and Trustees, section 374 (rev. 2d ed. 1977); IV Scott on Trusts section 368, 372 (3rd ed. 1967). See also Rev. Rul. 69-545, 1969-2 C.B. 117.

Section 513(a) of the Code defines the term unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it make of the profits derived) to the exercise or performance by an organization of the purposes or functions constituting the basis for its exemption under section 501. However, section 513(a)(2) further states that such term does not include any trade or business which is carried on by an organization described in section 501(c)(3) primarily for the convenience of its members, officers, patients, or employees. The patients of the hospital's staff physicians are not patients of the hospital. See Rev. Rul. 68-376, 1968-2 C.B. 246, and Rev. Rul. 85-110, this page, this Bulletin.

It is the position of the Service that the hospital's staff physicians are neither 'members' nor 'employees' of the hospital in their capacities as private practitioners of medicine. By providing laboratory testing services on tissue specimens referred by its staff physicians in their private capacities, the hospital is not carrying on an activity primarily for the convenience of its members, officers, or employees within the meaning of section 513(a)(2) of the Code.

However, because the facts show that the services provide a supply of specimens needed in the hospital's teaching program, they are substantially related to the exempt purposes of the hospital.

HOLDING

The Internal Revenue Service will follow that part of the decision in *St. Luke's Hospital of Kansas City v. United States*, 494 F. Supp. 85 (W.D. Mo. 1980), holding that a teaching hospital

which conducted nonpatient laboratory testing on specimens needed for the conduct of its teaching activities was not engaged in an unrelated trade or business where the outside testing services contributed importantly and substantially to the hospital's teaching program. On the other hand, the Service will not follow that portion of the decision in the St. Luke's Hospital case holding that a tax-exempt hospital's performance of a laboratory testing upon specimens obtained from private office patients of the hospital's staff physicians who are not parties of the hospital is not unrelated trade or business because the activity is performed primarily for the convenience of its members within the meaning of section 513(a)(2) of the Code.

See Rev. Rul. 85-110 for a discussion of the circumstances under which the provision by a nonteaching hospital of such laboratory services to nonpatients of the hospital will be considered related or unrelated trade or business.